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UNITED NATIONS CAPITAL DEVELOPMENT FUND

Report of the Administrator

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Summary

In 1995, the United Nations Capital Development Fund (UNCDF) issued the following challenge to donors: give UNCDF three years to deliver on the goals outlined in the 1995 policy paper entitled "Poverty Reduction, Participation and Local Governance: The Role for UNCDF", after which the Executive Board would have the unique opportunity to recommend closure of a United Nations entity if it was not successful.

An independent evaluation of the last three years clearly shows that UNCDF has realized the goals and implemented the new strategy set out in the 1995 policy paper. The evaluation concluded that "UNCDF has enhanced its distinctive identity by developing competence in the fields of decentralization and local governance, together with microfinance. The capacity of the institution has been improved and the preliminary judgement is that the new approaches have had a positive effect on field operations."

UNCDF not only made the changes requested by its donors and the Executive Board but it did so on time while maintaining a steady delivery of programming. This was accomplished by focusing on local government as its main partner together with civil society and the private sector; by focusing on fewer instruments; and by focusing on a smaller number of countries enacting or favouring policies of decentralization.

The evaluation concludes that for donors, "there is a good lesson that change can be managed" and that since UNCDF has indeed "enhanced its distinctive identity and developed competence in line with the 1995 Policy, donors should continue to support UNCDF".

I. PURPOSE AND BACKGROUND

1. The present report responds to Executive Board decision 97/8, in which the Board endorsed the new policy focus for the United Nations Capital Development Fund (UNCDF), entitled Poverty Reduction, Participation and Local Governance: The Role for UNCDF. The Board encouraged the Fund and the UNDP to intensify their collaboration and focus on the replication of successful programme experiences. The report also addresses a profoundly important challenge that the Fund accepted in 1995.

2. In 1995, UNCDF challenged donors to give UNCDF three years to deliver on the goals outlined in the 1995 policy paper, after which the Executive Board would have the unique opportunity to recommend closure of a United Nations entity if it was not successful. The present report therefore gives details of events that have taken place since that challenge and presents the results of the 1999 donor-led evaluation of UNCDF.

3. The UNCDF policy commitment. Building in part on its experience over the past 25 years and in part on the renewed interest in decentralized governance for poverty-focused, participatory local development, the Fund has made local governance the central objective of its work. The policy paper argued that UNCDF could "play a catalytic and pilot role in poverty reduction programmes in direct collaboration with communities and local governments". It defined a special niche at the interface of local government, civil society and the private sector to test new operational models for local governance and poverty reduction, which could be upscaled through close association with UNDP. In the policy paper, UNCDF promised that an accessible and flexible learning organization would be created, occupying territory not well covered by other development agencies and committed to fostering ownership through explicit partnerships with national and local institutions and strategic alliances with organizations such as the World Bank.

4. Focus became the key to the success of UNCDF in this corporate change process: focusing on local government as its main partner; focusing on four main instruments (local development funds prioritized and managed by local authorities; micro-credit and/or loan guarantee schemes; eco-development; and blueprint infrastructure projects); and focusing on a smaller number of countries enacting or favouring policies of decentralization. Ten of the 15 concentration countries are in Africa and account for 70 per cent of new project approvals for 1998. The Fund also restructured its programme portfolio and embarked on new procedures for project preparation, fundamentally rethinking project design and efforts to secure the active involvement of beneficiaries in programme development, implementation and evaluation.

5. Assessing capacity for corporate change. A donor-led capacity assessment (CAT) in 1996 confirmed that UNCDF was capable of reaching the poor with innovative project interventions and that it could play an important catalytic role in international development cooperation. Noting the ambitious scope of UNCDF policy and strategic change, the CAT recommended that UNCDF concentrate on:

(a) Refining the policy focus;

(b) Exploring synergy between UNCDF and UNDP;

(c) Improving the presence of UNCDF in the field through decentralization and other measures;

(d) Focusing on a smaller group of countries where the environment is conducive to decentralization and good governance; and

(e) Upgrading the competence of staff in the field and in New York.

The CAT encouraged UNCDF to become more risk-taking and innovative. It also supported efforts to develop monitoring, evaluation and communication capacity to ensure lessons and experiences were better articulated with national policies.

6. The donor commitment. The Fund's donors responded positively to these proposals, agreeing to provide stable funding over a three-year period. This multi-year funding commitment would enable the Fund to embed its new operational focus firmly and establish effective local partnerships through which to demonstrate its niche and the viability of the policy on local governance. The donor commitment also enabled UNCDF to embark on an ambitious training programme and to change the organizational structure while at the same time maintaining delivery, increasing approvals for new projects and sustaining its resource base. Donors furthermore accepted the UNCDF proposal to evaluate the results in 1999 and thereby provide a firm foundation on which to present proposals about the Fund's future to the Executive Board at its third regular session 1999.

7. UNCDF change strategy. The Fund's 1996 action plan - to follow-up on the CAT recommendations - began with the publication of strategy papers on local development funds (LDFs), eco-development, and Microfinance, which were critically examined by key partners, practitioners and academics through a series of focused workshops. Late in 1997, UNCDF commissioned independent reviews of these instruments and of support to the roads sector. The reviews of the LDF, eco-development and Microfinance projects prompted lively debate and a thorough rethinking of these instruments.

8. The review of eco-development projects confirmed there was much scope for UNCDF involvement in programmes linking local state institutions and communities, and particularly for community-based natural resource management. But major concerns were also identified: the environmental objectives were judged too static, many activities, such as "ecoswap" and data collection tools were heavily criticized, as was the lack of a coherent institutional strategy. The conclusion indicated the need for dramatic change.

9. For LDFs, both the conceptual rationale for supporting local government and the strategic pilot role for UNCDF were endorsed. However, it was argued that UNCDF should focus more on the institutional sustainability of local governments, on clearer participation strategies and on creating a "learning infrastructure" for generating and communicating lessons from experience.

10. The review of microfinance projects stressed the need for UNCDF to focus on the sustainability of MFIs. The review affirmed the primacy of institutional capacity assessment of MFIs to project success; the need to work directly with MFIs instead of wholesale support mechanisms; and the crucial importance of choosing the right partners.

Microfinance - Responding to critical review

The microfinance review emphasized the disconnection between the UNCDF stated objective of supporting sustainable microfinance and the fact that many of the institutions reviewed were either unlikely to become sustainable or did not provide enough reliable data to make an accurate judgement about their prospects for sustainability. The evaluation report on the field visits concluded that UNCDF is already following the recommendations of the review: "Malawi is instructive. It is only at late-formulation stage but follows the UNCDF innovative approach of inviting experienced small-credit providers - with proven track records for credit management and sustainability - to help to begin small-credit operations in new locations".

11. UNCDF responded quickly to these reviews and advice from workshops by preparing new policy papers on local governance, microfinance and infrastructure. UNCDF is to maintain its bedrock commitment to local development and poverty reduction through support to the improved delivery of basic infrastructure and local services as well as natural resource management. UNCDF will strengthen the capacity of local governments, the private sector and non-state institutions to undertake these poverty-reducing activities. Together with mechanisms to encourage local public involvement, community empowerment and democratic accountability, the Fund's local governance strategy focuses on elected local authorities as the prime, but not exclusive, partner for providing basic infrastructure and service delivery and as the hub of local institutional relationships.

12. In the future, infrastructure development will mainly be provided through the LDF multisectoral funding mechanism, focusing on small-scale rural investments, defined through local participatory planning. However, there may be cases where more sectorally focused funding facilities (e.g. sector investment funds) will also be supported to complement this approach. Larger, blueprint infrastructure investments may still sometimes be warranted for more strategic development reasons.

13. In addition, implementing the UNCDF commitment to developing sustainable microfinance in rural areas will give particular attention to two key issues: (a) the minimum conditions that need to be met in rural areas for microfinance to be successful and (b) the need to be risk-taking in supporting innovative mechanisms from microfinance institutions in their search for sustainability in rural environments. UNCDF will involve its technical partners in the design of projects to ensure greater quality and impact and proposes to work mainly in

support of the "retail" MFIs. The latter will allow for greater institutional and technical capacity-strengthening as well as closer monitoring.

Innovations in process and upscaling

Uganda has a strong commitment to decentralization and is about to begin devolving development funds to local governments. UNCDF and UNDP are assisting the Government to define and test practical procedures for transferring these resources to local governments to support the participatory planning and management of rural services. UNCDF designed the District Development programme (DDP) as a pilot in five districts with the explicit understanding that the World Bank would later expand the initiative to the entire country, building on the experiences and lessons learned from the first phase. The agreement triggered an exhaustive two-year formulation process encouraging all stakeholders, central and local governments, non-governmental organizations (NGOs) and community representatives, as well as donors such as the Danish International Development Agency (DANIDA) and the International Development Association to actively participate in defining the main features of the pilot programme.

The innovative formulation process was a major contributor to the rapid implementation after the agreement was signed in October 1997 for the $14 million UNCDF/UNDP commitment. As the donor evaluation concluded in January 1999, "... it is clear that the intensely consultative formulation process has had many lasting dividends: local governments are committed to the decentralization process; they regard DDP as 'their project' and, to an unusual degree, they have incorporated activities supported by the project into their normal operations. Indeed, many local governments began implementing key features of the design well before formal approval of the project". The special effort made by UNCDF to monitor, evaluate and communicate lessons has also paid off. Already, after just 18 months of implementation, the Government and the World Bank have incorporated all major features of the DDP into the design of the $70 million nation-wide upscale and as of 1999, the Government is using the programme as the pattern for all financing of decentralized planning and service delivery.

14. The policy review process is continuing, something the Fund believes is essential for a learning organization. From April 1999, with completion of its new draft policy, "Taking risks", it is the Fund's intention to pursue two broad interventions - good local governance and support to microfinance institutions. However, the evaluation concluded that the UNCDF "distraction with the policy debate left project design and the operation of the project cycle unreformed. The quality of project documents now significantly lags behind the examples of good work taking place on the ground." For this reason, and as recommended by the evaluation, UNCDF plans to concentrate on "disseminating the policy and the strategy to implement it".

15. The UNCDF donor evaluation. While the timeframe for implementing the 1995 policy and institutionalizing changes was very ambitious, UNCDF has clearly adhered to it. In September 1998, the donor-led evaluation of UNCDF began to address three questions:

(a) Whether the reorientation of the Fund's activities has enhanced its distinctive identity through its ability to take risks, test new methodological approaches and pilot innovations;

(b) Whether actions taken to implement the results of the CAT have been adequate;

(c) Whether the new approaches and processes have affected field operations.

16. A desk study review of headquarters operations was followed by visits to eight countries during January to March 1999. The synthesis evaluation report found that UNCDF has responded to the challenges of corporate change in a determined and positive way. The evaluation concluded that: "UNCDF has enhanced its distinctive identity by developing competence in the fields of decentralization and local governance, together with microfinance. The capacity of the institution has been improved and the preliminary judgement is that the new approaches have had a positive effect on field operations". The report highlighted progressive developments in three primary areas: policy; programmes; and organizational change.

17. Policy. Foremost is the conclusion that "there is little doubt that a causal link can be identified between empowerment, access to social infrastructure and poverty", thus vindicating the core of UNCDF policy strategy. In practice, the 1995 policy commitment has been realized through:

(a) A substantial increase in resources devoted to local governance;

(b) Increased attention, in 80 per cent of projects, to institution-building;

(c) A substantial growth in the inclusion of upstream policy development in all projects, including infrastructure projects.

18. It was argued in the evaluation that policy refinement, although thorough, was "overly long". However, the Fund has internalized the 1995 policy and has presented a new image and a new way of working. Earlier uncertainties and ambiguities in policy direction have now been resolved, such that "there is a strong uniformity in presentation of policy". Importantly, with major partners such as the World Bank, the policy thrust is well understood; it was noted in the report that this is "a significant achievement in two years" and that at the country level, there is "considerable donor interest".

19. It was also pointed out in the evaluation that UNCDF has successfully used "the experience of project work and field operations to refine policy and sharpen strategy". Moreover, the integration of participatory techniques into the policy instruments has been an important step towards "institution-building

and empowerment of the poor". The evaluation team believed the suspension of Eco-development projects "has prevented the wholesale application of an inappropriate and inefficient methodology; and the testing of the initial LDF principles and their adjustment ... have improved the methodology significantly".

20. Programmes. While the concentration strategy of UNCDF is often overlooked, it "is a key element in fostering the niche". Thematic concentration has seen a major shift in resources towards local governance and empowerment projects. A significant change has also occurred in line with country concentration. In 1995, when the concentration strategy was introduced, less than 40 per cent of approvals were in the 15 concentration countries. By 1998, this had increased to 88 per cent.

21. The innovative nature of UNCDF is manifest both in its approaches to formulation and in the content of its programmes. While the Fund recognizes that significant problems still exist in many countries, there is a clear trend to improvement, with "strong in-country support for the growing commitment of UNCDF to participatory project formulation and implementation". The evaluation found that UNCDF is delivering on its commitment to participation, in contrast to less-than-positive conclusions during the CAT review in 1996. There is "a significant effort ... to institutionalize participatory approaches ... the country visits confirmed this finding ... in summary, participatory methods and civil society strengthening are now common to most projects".

22. Other weaknesses pointed out by the evaluation will also need attention. Putting emphasis on the policy refinement, the evaluation determined that UNCDF had lost an opportunity to improve the quality of its products. It is argued in the evaluation that the quality of programme management has been adversely affected by the lack of a management information system (MIS), and that "in the absence of an MIS, there is no management analysis of the portfolio as a whole. This is a significant weakness, of which UNCDF is well aware". Similarly, the Fund was justifiably criticized for excessive flexibility and variable quality of project documents and poor performance in monitoring and evaluation.

23. Organizational change. The evaluation found an "active and open process of policy debate within UNCDF", a corporate feature that has intensified since the 1995 policy document.

24. As noted in the synthesis report of the evaluation, "UNCDF has internal strengths, which fit well with a more ambitious project portfolio. Notable are: a small team of committed and motivated staff; an open, non-bureaucratic and informal style; and increasingly involved and competent programme officers in the field. Importantly, UNCDF now has unique practical experience with the donor community of promoting decentralized capital development through local government in widely differing contexts".

25. Given these results, it was also argued in the evaluation that it is both necessary and feasible that UNCDF become a centre of excellence in planning and implementation of local governance and microfinance projects. This will require the Fund to emphasize further the "knowledge and ideas content" of programming

and to forge an even closer strategic alliance with UNDP through the global framework for promoting good governance.

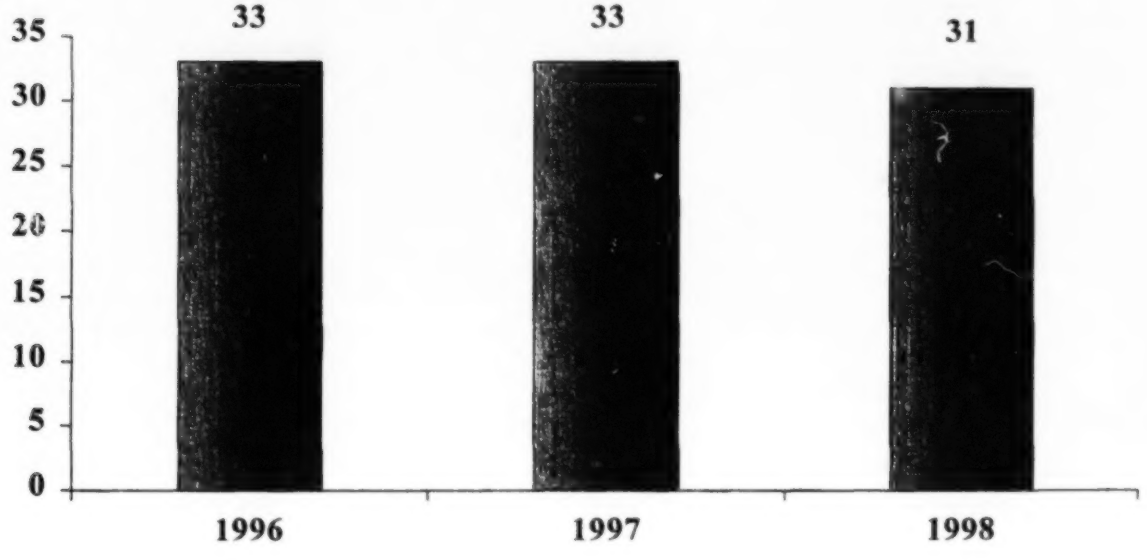
26. The evaluation team recommended that UNCDF reduce the current portfolio which would allow staff to concentrate further on the newer projects, intensify the knowledge content of programming and free technical resources to build strategic alliances with key partners, such as UNDP and the World Bank. To implement this recommendation, further development of the substantive competence of staff and substantial structural changes will be required.

27. In conclusion, the UNCDF evaluation determined that the Fund has enhanced its distinctive identity and has developed competence in line with the 1995 policy paper, and that donors should therefore continue to support it. However, the evaluation said funding "should be linked to performance targets, and results performance, with arrangements for objective verification and annual performance monitoring. The impact of new UNCDF policy projects should be the subject of an evaluation study within five years."

II. PROGRAMME ACTIVITIES

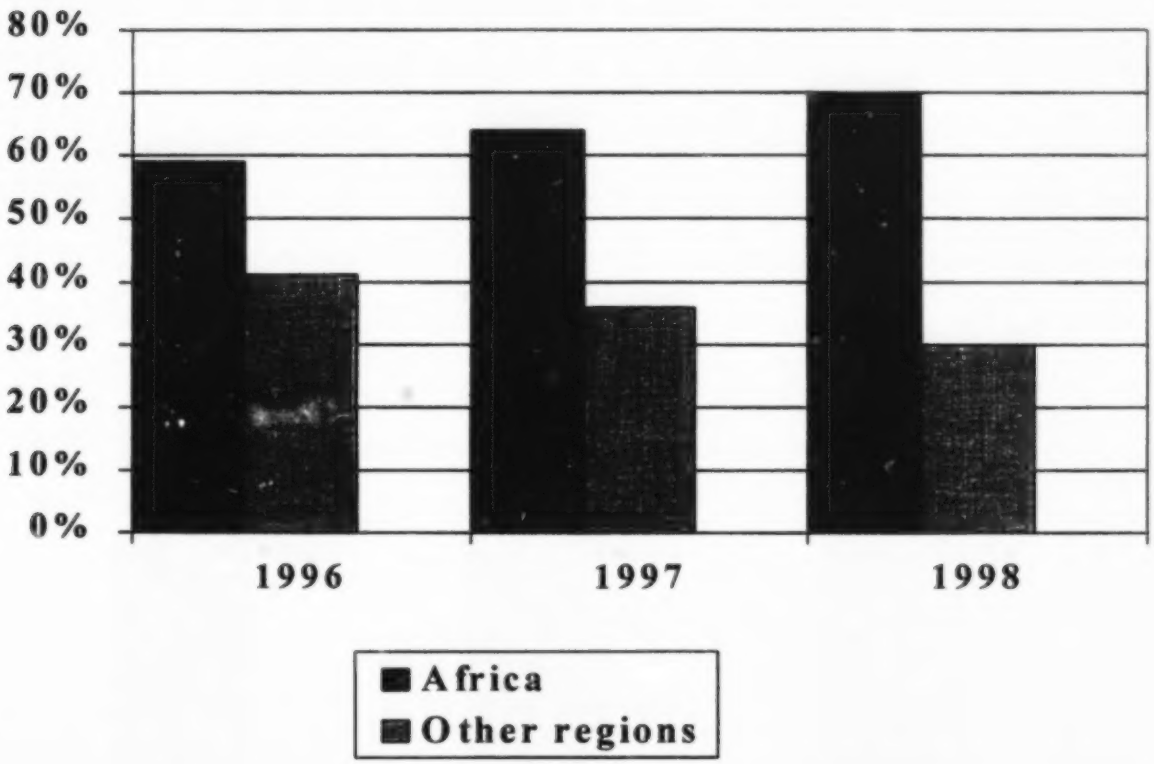
28. UNCDF activities in 1997-1998. In 1997, core contributions remained at the 1996 level of $33 million. Eight out of 10 donors increased their contributions in national currencies. In 1997, a strong US dollar offset by good investment of UNCDF resources kept the total resource base stable. In 1998, donor contributions declined to $31 million.

Figure 1 Donor Contributions



29. As previously mentioned, focus is key in UNCDF programming. By concentrating on a reduced number of countries and instruments, UNCDF can have a greater impact. During this two-year period, UNCDF approved projects worth a total of $106 million, including grant increases and had project expenditures of $82.2 million, reaching respectively 88 per cent and 98 per cent of targets. Since 1995, delivery has remained generally stable with an increase in 1998. This has been a major accomplishment given the changes taking place within the organization.

Figure 2 Approvals by Region (As percentage)



Delivery ($ millions)	
1995	40.4
1996	40.5
1997	38.2
1998	44.0

30. Concentration. In 1997, UNCDF developed a country concentration methodology that was used as a management tool for selecting 15 countries. This strategy has led to an increase in funding as well as programme monitoring by both technical and programme staff in those concentration countries. The thematic figure below shows how the number of approvals in local development funds and eco-development projects has increased while approvals in blueprint infrastructure projects has steadily declined. Only one microfinance project was approved in 1998 but this figure will increase since several are planned for 1999.

Figure 3 Thematic Approvals in 1994

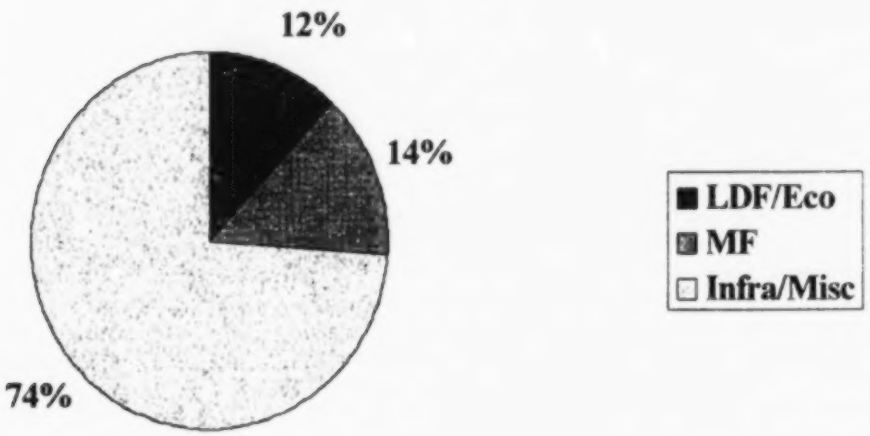
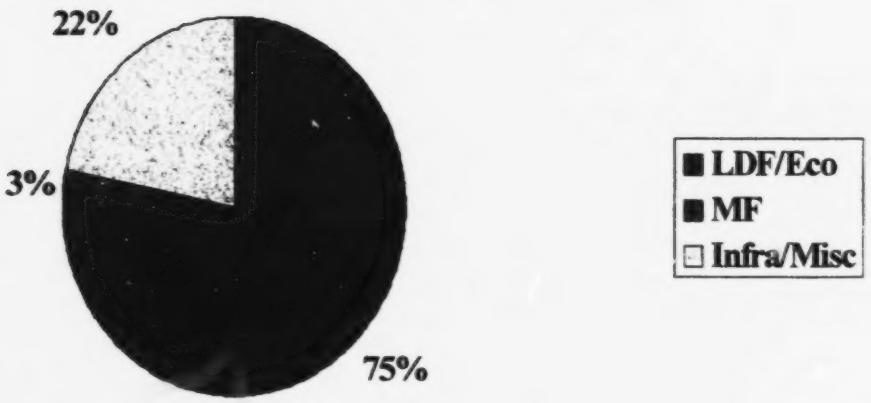


Figure 4 Thematic Approvals in 1995



31. UNCDF agrees with the evaluators' assessment that there are areas of programming that require attention, such as management information systems, the quality of project documentation and performance tracking, and inconsistency in the quality and scope of technical assistance provided. These are especially important in light of the recommendation that UNCDF move towards more "knowledge-intensive" practices and increase the "ideas-content" of our assistance.

32. Partnership with UNDP. UNCDF is not only a part of UNDP but UNDP is also the Fund's main partner both at headquarters and at the country-office level. UNCDF and UNDP have made the development of a closer relationship a priority over the last two years. This has resulted in increased synergy, a better understanding of their respective roles, and an emphasis on joint programming. UNCDF will now proceed with programming only where UNDP is financially committed to a joint programme. The signing of 15 memoranda of understanding in UNCDF concentration countries with the resident coordinators of the UNDP country offices outlines the nature of this relationship and responsibilities of each partner. The MOU is the main conduit between UNCDF and UNDP at the country-office level.

33. A memorandum of understanding was signed with the UNDP Evaluation Office, establishing an explicit partnership in the area of monitoring and evaluation relating to decentralization and governance programmes.

34. In September 1997, UNDP established the joint UNCDF/UNDP Special Unit for Microfinance (SUM), which is headed by the UNCDF Executive Secretary. SUM brings together the UNDP MicroStart Programme with the established credit and microfinance portfolio of UNCDF. Its purpose is to provide quality technical support and backstopping to country offices and UNCDF, to pool scarce financial and human resources and to enhance the effectiveness and ability of UNDP and UNCDF to work with the donor community and the private sector.

35. Links with key partners. UNCDF and the World Bank work together in a growing number of countries, including Malawi, Senegal and Uganda. UNCDF cooperation with the World Bank at country and headquarters levels involves regular strategic and programme discussions and joint missions. During 1998, a joint IDA/UNCDF mission assisted the Government of Malawi to define the local government fiscal transfer system, paving the way for Parliament to approve the decentralization policy. In Uganda, UNCDF is an integral partner in preparation of the nation-wide IDA-financed Local Government Development Programme, and has actively promoted the involvement of the Department for International Development of the United Kingdom and DANIDA in this process. The association of UNCDF with the World Bank has also included the Rome Conference on Decentralization and UNCDF is currently co-sponsoring a comparative study, looking at World Bank social funds and alternative models for small-scale infrastructure delivery at the local level.

36. UNCDF has continued to build on its partnerships with bilateral donors such as Australia in Viet Nam, Belgium in Mali and Niger and the Netherlands in Mozambique. The European Union is currently discussing committing $21 million towards replicating the local development fund programme in the West Bank and Gaza. In Uganda, UNCDF has embarked on joint annual review missions with the Netherlands to ensure synergy in support to decentralization.

37. Networking studies have identified potential technical partners in Southern, East and West Africa, with which UNCDF is making contacts to assess the options for collaboration. The partnership with the Asian Institute of Technology, following the 1997 agreement, is developing joint programme support activities in Bangladesh, Bhutan, Cambodia and Viet Nam.

38. Results of programme evaluation. During 1997 and 1998, UNCDF conducted 29 mid-term and final project evaluations, several of which were important inputs for the three internal thematic reviews of eco-development, local development fund and microfinance projects. Yearly synthesis reports of evaluations include thematic analyses. The 1997 report examined microfinance and roads. The 1998 report, to be published in August 1999, will focus on institutional analysis and project implementation issues. Projects are overcoming earlier weaknesses and show greater success in achieving their immediate objectives by defining the right product/project concepts, identifying needs appropriately, and carefully targeting beneficiaries. There was notable improvement in project performance but additional monitoring is required to determine the sustainability of this performance. Further efforts are needed in community sensitization, monitoring and supervision, and coordination at the district/sectoral level.

39. Over the past two years, improvements have occurred by integrating monitoring and evaluation systems within programmes. Since September 1998, UNCDF has included logical frameworks in all new programme and project documents with clear indicators and means of verification. This move led to the reduction of the number of immediate objectives in programmes, making them much more strategic and targeted. Monitoring and evaluation systems have been discussed and designed with the participation of beneficiaries during the formulation stages of the programmes. Corporate key performance indicators were established for microfinance projects and are in the process of being finalized for the local development programmes. On this basis, UNCDF is also addressing weaknesses in data management that will enable the integration of country offices and headquarters. The new system will be rolled out during 1999.

40. The way forward. UNCDF is pleased with the positive evaluation. As the evaluation notes, "For the donors, there is a good lesson that change can be managed". Significant results can be achieved in a relatively short time-frame. The Fund has a clear policy niche, is able to focus through the country concentration strategy and has profoundly changed its identity and way of doing business. Throughout, delivery has been maintained. By supporting democratically accountable local governments, UNCDF has demonstrated that civil society can be empowered and the local private sector stimulated to participate in poverty reduction. UNCDF has developed innovative participatory methods, improving in relevance, targeting and efficiency. The evaluation team highly praised UNCDF staff commitment and efforts to improve the core competencies required for the organization. The evidence shows that UNCDF is well placed to become a centre of excellence in the planning and implementation of local governance and microfinance programmes. At the corporate level, it is now crucial for UNDP and UNCDF to focus on how a future UNCDF, specializing in pilot projects in local governance, can further advance UNDP corporate goals in the governance arena.

41. UNCDF has already begun to implement many of the recommendations from the initial evaluation reports. In order to become a centre of excellence, UNCDF is taking the necessary steps to improve (a) the quality of its programme and project documents; (b) its ability to collect and disseminate lessons learned; and (c) the structure of the organization to respond better to the technical needs of the programmes. The number of regional technical advisors will increase and the capabilities of the programme officers will be upgraded. It will also restructure headquarters by making the operational division covering governance more technical and by integrating SUM completely into UNCDF as the second operational division.

42. By endorsing the recommendation contained in the evaluation to continue to support UNCDF, the Executive Board will enable the Fund to intensify its knowledge base, further improve the quality of programmes and reinforce the corporate results orientation. The future of UNCDF in the longer term will be linked to an evaluation of its impact to be carried out in 2004.

III. EXECUTIVE BOARD ACTION

43. The Executive Board may wish to:

1. Take note of the present report;

2. Welcome the positive results from the donor-led evaluation of UNCDF and strongly endorse its future as a centre of excellence in the planning and implementation of local governance programmes and microfinance;

3. Appeal to countries to make voluntary contributions resulting in the sustained increase of available funding;

4. Encourage UNCDF to take the necessary action to implement the recommendations of the evaluation and to report to the Executive Board on its performance in 2001;

5. Encourage the Fund and the UNDP to intensify their collaboration in all relevant areas, most particularly in the field of local governance and microfinance;

6. Encourage UNCDF to strengthen strategic alliances with partners, including Governments, bilateral donors and multilateral organizations through discussion and dissemination of the new policy on local governance and microfinance;

7. Request the Administration to carry out an evaluation of the impact of UNCDF programmes and projects in 2004 and to report to the Board thereon.